

ECONOMIC OUTLOOK

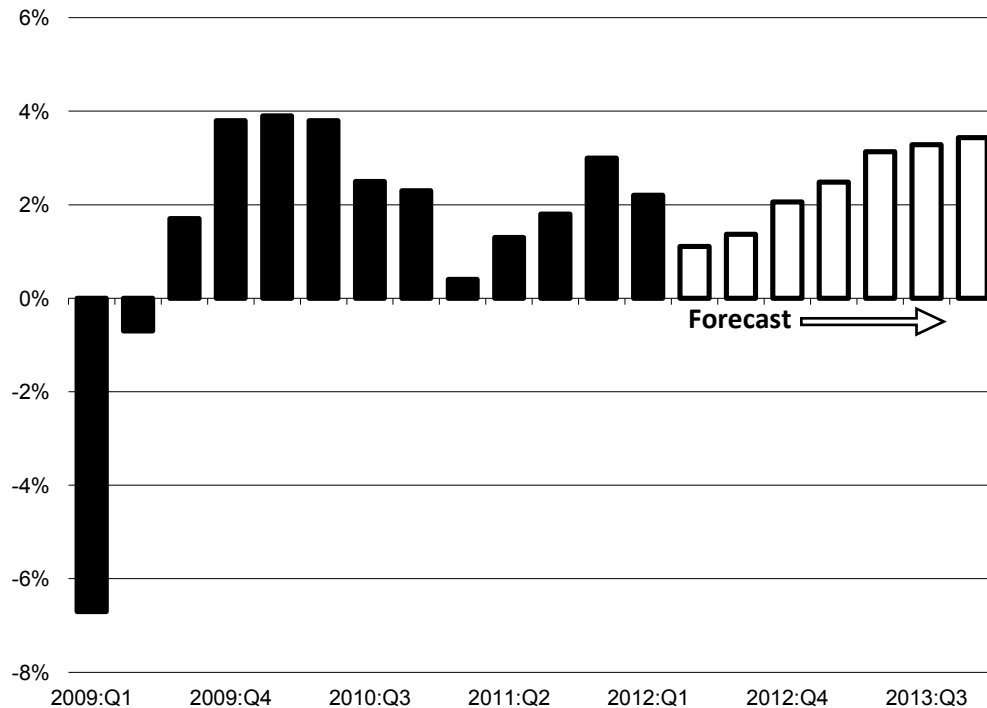
The California and national economies are recovering at a modest pace. The economic outlook has improved slightly since the Governor's Budget. Labor markets made higher gains in the latter half of 2011, but growth moderated in the early months of 2012. Consumer attitudes and spending and business investment have been improving. Gross Domestic Product (GDP) growth is projected at a higher level for 2012 (Figure ECO-01). The risks to recovery are now projected to be much lower. However, real estate conditions and unemployment rates continue to limit growth.

The biggest change in the California outlook stems from incorporating assumptions about the impact of the initial public offering of Facebook stock. It may turn out to be one of the largest initial offerings in U.S. history and far larger than all of the recent offerings in the internet sector. Since the company, its founder, principal employees, and many of its initial investors reside in California, it is projected to have a significant positive impact on California personal income in the latter half of 2012, increasing it by 1.7 percent.

THE NATION

The national economy is recovering at a slow, yet steady pace. Labor market conditions are gradually improving. Despite some volatility that was likely caused by an unusually warm winter in many areas of the country, payroll job growth has strengthened.

Figure ECO-01
National Real GDP
Quarter-to-Quarter Growth, Annualized



Source: U.S. Bureau of Economic Analysis; CA Department of Finance May Revision Forecast

- Nonfarm employment expanded by 201,000 per month on average during the first four months of 2012, compared to growing 153,000 per month in 2011, and 86,000 per month in 2010.
- The national unemployment rate, while still high at 8.1 percent in April, has been gradually improving since August 2011.
- Initial and continuing claims for unemployment benefits continued a two-year decline during the early months of 2012.

Better employment conditions are translating into rising incomes, better consumer sentiment, and more consumption expenditures.

- Personal income in March 2012 was 3.2 percent above its level of one year ago, while wages and salaries grew 4.4 percent from a year earlier.

- During the first quarter of 2012, consumer sentiment had fully recovered from the mid-2011 slump.
- In February 2012, consumer spending saw its largest gain since July 2011, led by a 900,000-unit increase in vehicle sales. Consumer spending contributed more than 2 percentage points to real GDP growth in the first quarter of 2012.

In addition to consumer spending, rising capital investment has been a significant driver of recent economic growth. Businesses are filling equipment upgrade and replacement needs postponed during the recession. Business spending on equipment and software expanded over 10 percent in 2011—outpacing the growth of all other GDP spending categories.

Rising global demand for U.S. goods and services has been an important component of the recovery. Exports slowed sharply during the recession before rebounding when the recovery began. They grew by more than 11 percent in 2010 and 6.7 percent in 2011. However, the appreciation of the dollar and spreading weakness in the Eurozone will dampen export growth going forward.

The absence of a recovery in real estate markets has been the main drag on the recovery. However, tentative signs have emerged that housing markets may have stabilized.

- In February 2012, the S&P/Case-Shiller 20-City Home Price Index posted its first gain since March 2011.
- The volume of home sales has been on a modest rising trend since the middle of 2011, largely supported by investor purchases.
- The value of homebuilding activity in March was up over 7 percent from a year earlier, with nearly all of the gains coming from multifamily construction.

CALIFORNIA

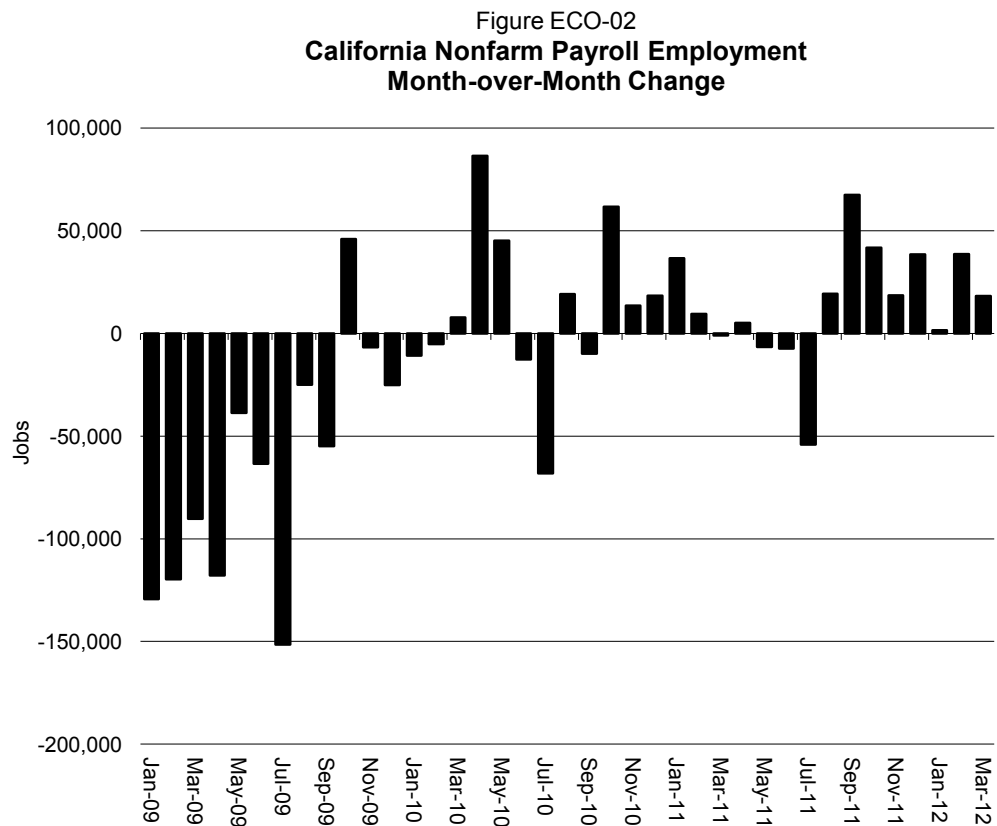
California regions that are home to high-technology, high-wage, and/or export-driven industries are doing relatively well. The remaining areas of the state are still affected by weak housing markets and public sector financial troubles.

California is benefiting from its attractiveness to venture capitalists. In 2011, California accounted for more than half of the entire nation's venture-backed investment—for the fourth consecutive year—led by software and biotechnology. A substantial portion of the state's recent jobs gains stemmed from hiring in high-wage industries such as

computer design, semiconductor manufacturing, information technologies, and scientific and technical research. This focus on high-technology industries has boosted California incomes. For example, the Facebook IPO could result in about \$12 billion of additional income for California residents in the latter half of 2012.

California continued to benefit from strong export growth. After a 19-percent gain in 2010, California exports rose 11 percent in 2011. Computers, electronics, electronic machinery, and transportation equipment accounted for over 30 percent of this growth. Among recipients, Mexico accounted for nearly 32 percent of the 2011 export gains.

In contrast, labor markets are making slower and less consistent progress. After accelerating in the second half of 2011, nonfarm employment growth slowed at the beginning of 2012—from an average monthly gain of 37,000 jobs during the last five months of 2011 to 19,000 on average during the first three months of 2012 (Figure ECO-02). The fastest growing industry sectors included information; professional, scientific, and technical services; and private educational services.



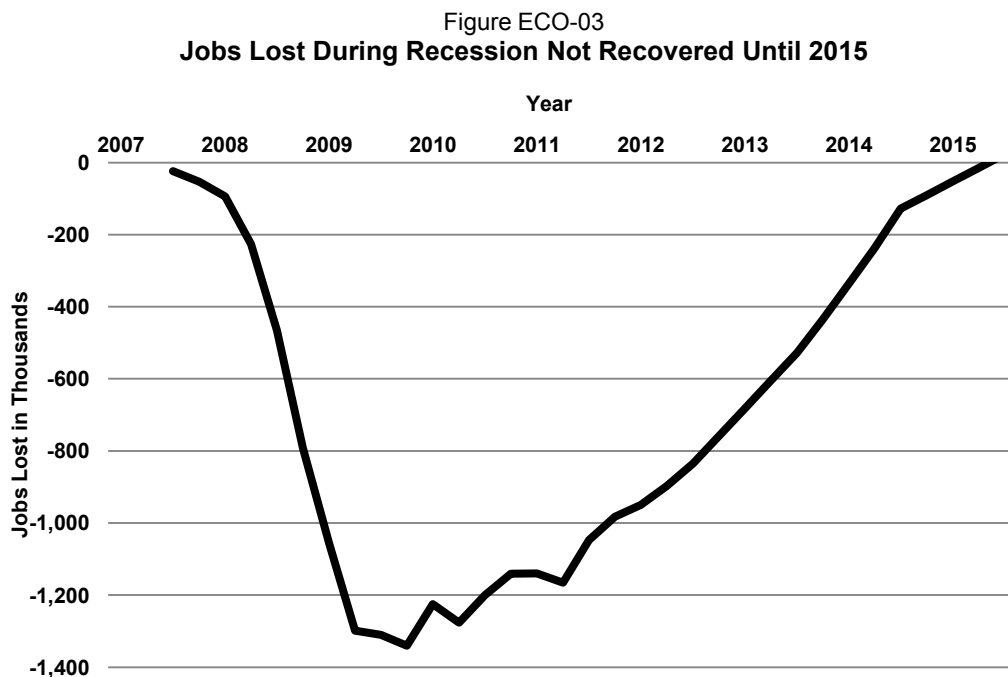
Source: Employment Development Department, Labor Market Information Division

California's housing markets appear to have reached their low points and are recovering slowly.

- Driven to a large extent by investors, home sales have increased from the 469,000-unit pace in the middle of 2011 to a 517,000-unit pace in the first quarter of 2012.
- Although still much higher than historic levels, notices of default have declined to 257,700 in 2011 from their peak of 456,300 in 2009.
- The \$268,300 median sales price of existing single-family homes sold in January 2012 was up 8.4 percent from the lowest price recorded during the recession—\$247,600 in February 2009.

THE FORECAST

The outlooks for the nation and California are slightly higher than the Governor's Budget forecast. Both economies are expected to continue to make slow but steady progress. The recovery is on firmer ground, with a much smaller risk of slipping into another recession. As shown in Figure ECO-03, California is forecast to recover the



nonfarm jobs lost during the Great Recession in the fourth quarter of 2015, rather than in the second quarter of 2016 as was previously forecast.

Weak housing markets and job growth have made this the slowest recovery in the post-World War II era. Barring serious disruptions, job and wage growth will lead to a balanced expansion. The national economy is forecast for real GDP growth in 2012 and 2013 of 2.2 percent and 2.4 percent, respectively, while 3.4 percent is projected for 2014. The risks to economic recovery are from instability in Europe and the Middle East, as well as potential changes to address the federal deficit.

See Figure ECO-04 and Figure ECO-05 for highlights of the national and California forecasts.

Figure ECO-04
Selected U.S. Economic Indicators

	2011 (Est.)	2012 (Projected)	2013 (Projected)
Real gross domestic product, (2005 dollar) (Percent change)	1.7	2.2	2.4
Personal consumption expenditures	2.2	2.1	2.2
Gross private domestic investment	4.8	9.0	7.0
Government purchases of goods and services	-2.1	-1.6	-1.8
GDP deflator (2005=100) (Percent change)	2.1	1.4	1.4
Federal funds rate (Percent)	0.10	0.10	0.10
Personal income (Percent change)	5.1	3.7	4.2
Corporate profits before taxes (Percent change)	7.9	1.1	0.2
Nonfarm wage and salary employment (Millions)	131.4	133.5	135.7
(Percent change)	1.2	1.6	1.7
Unemployment rate (Percent)	9.0	8.2	7.9
Housing starts (Millions)	0.61	0.74	1.01
(Percent change)	4.3	21.2	36.1
New car and light truck sales (Millions)	12.7	14.2	14.9
(Percent change)	10.3	11.8	4.6
Consumer price index (1982-84=100)	224.9	229.7	234.3
(Percent change)	3.2	2.1	2.0

Forecast based on data available as of April 2012.

Percent changes calculated from unrounded data.

Figure ECO-05
Selected California Economic Indicators

	2011	Percent change	Projected			
			2012	Percent change	2013	Percent change
Personal income (\$ billions)	1,685.8	6.0%	1,769.0	4.9%	1,830.0	3.4%
Nonfarm W&S employment (thousands)	14,085.2	1.1%	14,284.6	1.4%	14,550.9	1.9%
Mining and logging	28.4	5.8%	29.4	3.5%	30.7	4.6%
Construction	559.7	-0.1%	573.9	2.5%	608.5	6.0%
Manufacturing	1,244.6	0.3%	1,255.2	0.8%	1,285.6	2.4%
High technology	345.9	0.7%	348.3	0.7%	359.0	3.1%
Trade, transportation, & utilities	2,661.6	1.5%	2,701.3	1.5%	2,742.3	1.5%
Information	430.2	0.6%	434.0	0.9%	442.0	1.8%
Financial activities	763.1	0.4%	767.7	0.6%	774.7	0.9%
Professional and business services	2,133.8	2.9%	2,212.1	3.7%	2,272.6	2.7%
High technology	334.2	4.7%	348.8	4.4%	363.3	4.2%
Educational and health services	1,834.6	2.6%	1,872.0	2.0%	1,914.9	2.3%
Leisure and hospitality	1,538.3	2.5%	1,568.1	1.9%	1,594.8	1.7%
Other services	492.7	1.6%	500.8	1.7%	513.4	2.5%
Government	2,398.3	-2.0%	2,370.1	-1.2%	2,371.4	0.1%
Unemployment rate (annual average)	11.8%		10.9%		10.4%	
Housing permits (thousands of units)	47	6.2%	53	12.1%	81	53.5%
Consumer price index (1982-84=100)	232.9	2.6%	237.7	2.0%	242.5	2.0%

*Forecast based on data available as of April 2012.
Percent changes calculated from unrounded data.*

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